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IN THE

Supreme Court of the United States

October Term, 1967

No. 292

ANTHONY M. REINACH,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Anthony M. Reinach, your petitioner, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above entitled case on April 14, 1967.

Opinions Below

The opinion of the Court of Appeals has been reported at 373 F. 2d 900. It is reproduced in Appendix A hereto, page A1.

The opinion of the Tax Court was a memorandum opinion (T. C. Memo 1965-288) and was not formally reported.

Jurisdiction

The opinion of the court below (Appendix A, page A1) was entered on February 27, 1967. A timely petition for rehearing was denied on April 14, 1967.

Questions Presented

1. Where a sale is made to a customer in the regular course of business, will the resulting gain or loss be transformed into a capital gain or loss if the transaction is kept open by delivering borrowed stock to the customer and waiting from one to three years before making a purchase of the stock and repayment to the lender?

2. Is the sum of money or shares of stock, equivalent to a dividend, paid by a borower of stock to the lender to maintain a short position, a deductible expense under either Section 165 or Section 212 of the Internal Revenue Code?

Statutes Involved

The following statutory provisions are set forth in Appendix B:

Internal Revenue Code of 1954

Sections 165(a), (b) and (c), 212, 1221, 1233(a).

Statement

In the taxable years under examination, Anthony Reinach was a self-employed writer of put and call options,

to which end he rented office space, hired a secretary, and incurred other related expenses.[1]

From March 29, 1956 to August 7, 1958, Reinach wrote 412 option contracts. In the case of options which were exercised, the Court of Appeals for the Second Circuit found his behavior significant: In every case of an exercised put, Reinach disposed of the put stock immediately; he never held onto a stock put to him in order to speculate on a subsequent price rise. In the case of calls, in not one instance did he own (or was he "long") the shares involved in these options when he wrote them.

In exercising a call, the optionee would present the call to Ira Haupt & Co. ("Haupt"), the endorser, which then notified Reinach that Haupt had sold and delivered for

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[1] A "put" is an option to sell and a "call" is an option to buy a specified number of shares of stock at a set price at any time within an agreed upon period. These options are granted in consideration of a cash payment, the "premium". Standard form contracts are used for puts and calls; each option is negotiable and is endorsed by a member firm of the New York Stock Exchange. Ordinarily, puts and calls are issued on blocks of 100 shares of a popular stock listed on a national exchange. The duration of the option usually ranges from thirty days to six months and ten days. The price at which the named stock can be put or called is ordinarily the market price when the option is written and is termed the "striking price". In order to exercise an option, it must be physically presented before expiration to the stock exchange firm that endorsed it. Options are customarily purchased by the public from put and call broker-dealers, but it is seldom they who create the option contracts they sell. Rather, that is the function of writers; the writer is in contact with the put and call broker. Either one or the other may suggest writing a particular option; then they negotiate the terms, the principal bargaining point being what premiums the writer will receive. Premiums vary depending on numerous factors, including the risk to the writer, the particular option involved and the demand from the public. The broker's gross profit is the difference between the premium he charges his customer and what he must pay the writer.

his account shares to the optionee. At the same time, Haupt would collect the option price for the stock from the optionee and credit it to Reinach. On 96 of the 122 occasions when calls were exercised, Reinach ordered Haupt, as his broker, to immediately purchase shares in the market to cover those Haupt had bound itself as endorser to deliver to the optionee. But on 26 occasions (about 1 case in 5), Reinach departed from that course and after the sale of stock to the optionee he did not immediately replace the stock Haupt had delivered to the optionee. While "short" the stock, Reinach paid to Haupt sums equivalent to dividends declared on the stock. Eventually, Reinach purchased equivalent stock in the market to "cover" the short sale, i.e., repay Haupt for the loan of stock. Seven of such short sale transactions culminated on December 28, 1959; although one brought Reinach a profit, the eventual purchase price Reinach paid on the other six was in excess of the original premium and striking price Reinach had received from the call optionee. It is Reinach's contention that for tax purposes this difference is his net loss and that his total net losses on the transactions of over $59,000 are ordinary losses.

Reasons for Granting Writ

I

On the foregoing facts, the Court of Appeals held that Reinach's decision to keep some option transactions open, through a short sale of securities to his customer, the option holder, transformed those transactions from ordinary to capital transactions; and that, consequently, the entire gain or loss on the whole transaction was a capital gain or loss.

This decision of the Court of Appeals for the Second Circuit squarely conflicts with the decision of the Court of Appeals for the Fourth Circuit in the case of *John W. Williamson et ux* v. *Commissioner*, 201 F. 2d 564 (1953); aff'g 18 T. C. 653; Cert. den. 345 U. S. 970. In that case, an individual in the business of buying and selling cotton used several methods of sale in his business. One of the methods was known as a sale on "call", which was described by the Court of Appeals for the Fourth Circuit, in its decision, as follows:

> "In a 'call' transaction, the cotton is delivered into the possession of the buyer immediately upon the consummation of an agreement but the price to be paid therefor is deferred for future determination. Cotton sold on call immediately becomes the property of the buyer, who assimilates it into his inventory, bears the responsibility for warehouse and insurance charges, and may use or sell the cotton or do with it as he will. The seller is granted a specified period within which he may call the contract. The price determination is based on the market quotation prevailing on the date the actual call is made.
>
> "In the interval between the delivery to the buyer and the call by the seller, the risk of market fluctuations is on the seller. A further refinement of this system permits the seller to receive a certain percentage of the current market price immediately upon delivery. Thereafter, if the market advances, he may require the buyer to make additional payments to preserve the margin initially established. If the buyer retreats, the buyer may make similar demands upon the seller, final settlement between them being based on the market prevailing on the 'call date'."

The Court of Appeals for the Fourth Circuit upheld a Tax Court finding that the cotton involved in the "call" sales was not a capital asset because held by the taxpayer for sale to customers in the ordinary course of his business. The Court of Appeals then went on to make a determination as to the contention that there is a distinction between sales to a customer in the ordinary course of business where the transaction is closed immediately, and a sale to a customer in the ordinary course where the transaction is not closed immediately and the seller continues to assume the price risk although delivery has been made. The Court said:

> "The short answer to that contention is that the taxing statute recognizes no such distinction, and we are not permitted to create one by judicial interpretation. To do so would not only subvert the purpose of the statute but do violence to its express language. Although counsel have not called our attention to any cases dealing with the sale of commodities on call contracts, and we have found none, it is clear that Congress intended to exclude from the benefits of capital gains taxation property held for disposition in the ordinary course of business. *Gruver* v. *Commissioner*, 142 F. 2d 363.
>
> "In view of this manifest legislative intent, it is evident, we think, that taxpayer cannot convert property so held into a capital asset merely by deferring the price determination until a future date. Nor can he, by injecting this single, speculative element into a transaction which in all other respects is an ordinary sale to customers in the course of his business, gain for himself a tax advantage to which he is clearly not entitled."

The opinion of the Court of Appeals as to judicial interpretation is in accord with the oft repeated admonition to

the courts to be guided by the everyday meaning of words used in the statute and not to create distinctions which would enlarge the area of capital gain tax relief. *Corn Products Refining Co.* v. *Commissioner,* 350 U. S. 46 (1955).

Reinach's transaction is similar to that of the taxpayer in *Williamson* (*supra*). Reinach, having sold an option to a customer in the ordinary course of his business would, as the record shows, be required to exercise the option in 30% of the cases. The exercise of the option meant that Reinach had to sell the stock covered by the option to his customer or the customer's assignee, as the options were freely assignable. The exercise of the option resulted in a sale by Reinach to his customer in the regular course of business for it was the regular course (in 30% of the cases) for Reinach to have to sell stock to his customer or the customer's assignee. The holding by the Court of Appeals for the Second Circuit that Reinach's persistence (in 1/5 of the cases) in keeping the transaction open for such lengthy periods of time, rather than covering immediately, transformed the transaction into something other than an ordinary sale in the course of business, is directly opposed to the opinion of the Court of Appeals for the Fourth Circuit in the *Williamson* case. Remarkably, the rationale for holding against Reinach, used by the Court of Appeals for the Second Circuit, is precisely the same argument which Williamson advanced in his case and which the Court of Appeals for the Fourth Circuit rejected.

II

While *Williamson* (*supra*) involved profits from market speculation on the sale side of the transaction, the instant decision also conflicts with a line of cases which involved profits earned by market speculation on the purchase side of the transaction. The cases holding such profits to be ordinary income are all Tax Court cases including *America Southeast Asia, Inc.,* 26 T. C. 198; *Bennett's Travel Bureau, Inc.* v. *Commissioner,* 29 T. C. 350; and *Willard*

Helburn, Inc. v. *Commissioner,* 20 T. C. 740; affd. 214 F. 2d 815 (C. A. 1, 1954). In the *America Southeast Asia* case, the Tax Court relied upon *Church's English Shoes, Ltd.,* 24 T. C. 56 (1955); affd. 229 F. 2d 957 (C. A. 2, 1956), as well as the following cases: *United States* v. *Kirby Lumber Co.,* 284 U. S. 1, (1931); *Jacob M. Kaplan,* 21 T. C. 134 (1953); *Spear Box Co.,* 13 T. C. 238 (1949), affd. 182 F. 2d 844 (C. A. 2, 1950; *Reliable Incubator & Brooder Co.,* 6 T. C. 919 (1946); and *Estate of W. R. Whitthorne,* 44 B. T. A. 1234 (1941). In this line of cases, importers who speculated in foreign currency by going short in hopes of profiting from devaluation have been held to earn ordinary income if the short position in foreign currency covers a purchase of foreign goods made in the ordinary course of business. The Tax Court in *America Southeast Asia Inc.* (*supra*), recognized the existence of two transactions—one a purchase of foreign goods, and one a speculation in foreign exchange; but neither the presence of two transactions nor the length of time involved in keeping the short position open untied the profit on the short transaction from taxation as ordinary income. Thus, whether the instant decision in Reinach's case is bottomed on the thought that going short stock sold to an optionee is a separate transaction from the sale of the option itself, or the theory that the mere length of time in staying short is enough to transform the transaction, the decision itself conflicts with the decisions in the above cited Tax Court cases.

III

The Court's decision in this case affects the entire put and call industry, (except for those within the jurisdiction of the Court of Appeals for the Fourth Circuit). Heretofore, writers of puts and calls who were engaged in this business could assume that a sale of stock to an optionee was an integral part of the business and, accordingly,

could never be transformed into a capital gain or loss. The rule of the Court of Appeals for the Second Circuit opens a new loophole which put and call writers will be able to use to reduce their taxes. By simply delaying the close of the transaction, as Reinach did, they will transform into a capital gain what the Court of Appeals indicates would otherwise be an ordinary gain and, as the Court of Appeals pointed out, there could well be substantial gains involved. Not only put and call writers could use this loophole but, practically speaking, any alert business man (except those within the jurisdiction of the Court of Appeals for the Fourth Circuit) dealing in fungible goods could use the same technique to convert profits on sales to customers into capital gains providing the sellers were willing to take the market risk as did Williamson. The rule that traders in securities (those who do not sell to customers but use the facilities of an organized exchange to procure a buyer) receive capital gain and loss treatment would not block the loophole for, as this Court pointed out, sales of securities made to a customer in the regular course of business will not receive capital gain and loss treatment. *Schafer* v. *Helvering,* 299 U. S. 171 (1936).

The Court's decision will also encourage litigation on the question of "How long need one keep a transaction open before it is transformed into a capital transaction?" There will be cases where transactions will be kept open one day and other cases for a month and still others for longer or shorter periods and, in each case, there will be litigation if the present rule is permitted to stand. Every taxpayer who is able to cast his transaction in the form which Reinach did (and who is not in the jurisdiction of the Court of Appeals for the Fourth Circuit) would have open to him this capital gain route if he was willing to continue to take the market risk for a period beyond the actual delivery date, by using a "call" form in the sale to a customer.

IV

The Court's decision in failing to allow as a deduction the dividends which Reinach paid to the lender, while he remained short the stock, is in direct conflict with decisions of four Courts of Appeal, viz., the decision of the Court of Appeals for the Fourth Circuit in *J. A. Dart* v. *Commissioner,* 74 F. 2d 845; the Court of Appeals for the Ninth Circuit in the case of *Commissioner* v. *F. A. Wilson,* 163 F. 2d 680, Cert. den. 332 U. S. 842; the Court of Appeals for the Sixth Circuit in the case of *Commissioner* v. *Wiesler,* 161 F. 2d 997, Cert. den. 332 U. S. 842; and the Court of Appeals for the Seventh Circuit in the case of *L. H. Lewis,* 328 F. 2d 634, Cert. den. 379 U. S. 821.

The decision herein, barring a deduction for dividends paid by a short seller, appears to be in conformity with a prior decision of the Court of Appeals for the Second Circuit in the case of *Commissioner* v. *Levis Estate,* 127 F. 2d 796. This issue as to whether dividends paid by a short seller to the lender of the stock are deductible expenses under either Section 165 or 212, affects a large number of stockholders who are given differing tax treatment, depending on whether they live within the jurisdiction of the Second Circuit or the jurisdiction of the Fourth, Sixth, Seventh or Ninth Circuits.

CONCLUSION

To resolve a conflict between the Circuit Courts and to provide for uniform treatment of taxpayers regardless of their domicile, the petition for writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX "A"

Opinion of United States Court of Appeals for the Second Circuit

FEINBERG, *Circuit Judge*:

Taxpayer Anthony Reinach petitions for review of a decision of the Tax Court[1] affirming the assessment of certain deficiencies for the taxable years 1956, 1959, and 1960. We are asked to determine whether losses taxpayer sustained were capital or ordinary and, if the latter, whether the losses occurred in 1959 or 1960. We conclude that taxpayer's losses were capital and affirm the judgment of the Tax Court.

In the taxable years under examination, Anthony Reinach was a self-employed writer of put and call options, to which end he rented office space, hired a secretary, and incurred other related expenses. To understand the legal issues in dispute it is necessary to describe—in an oversimplified way to be sure—the put and call market. A "put" is an option to sell and a "call" is an option to buy a specified number of shares of stock at a set price at any time within an agreed-upon period. These options are granted in consideration of a cash payment, the "premium." Standard-form contracts are used for puts and calls;[2] each option is negotiable and is endorsed by a member firm of the New York Stock Exchange. Ordinarily, puts and calls are issued on blocks of 100 shares of a popular stock listed on

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[1] 24 CCH Tax Ct. Mem. 1605 (1965).

[2] They are copyrighted and issued by the Put and Call Brokers & Dealers Association, Inc.

a national exchange. The duration of the option usually ranges from thirty days to six months and ten days. The price at which the named stock can be put or called is ordinarily the market price when the option is written and is termed the "strikng price." In order to exercise an option, it must be physically presented before expiration to the stock exchange firm that endorsed it. Options are customarily purchased by the public from put and call broker-dealers, but it is seldom they who create the option contracts they sell.[3] Rather, that is the function of writers; the writer is in contact with the put and call broker. Either one or the other may suggest writing a particular option; then they negotiate the terms, the principal bargaining point being what premium the writer will receive. Premiums vary depending on numerous factors, including the risk to the writer the particular option involves and the demand from the public. The broker's gross profit is the difference between the premium he charges his customer and what he must pay the writer.[4] The maximum profit an option writer can make from writing the option alone[5] is the full premium he receives. This he keeps, of course, when the stock price either remains steady during the option life or fluctuates in his favor, *i.e.*, declines on a call or rises on a put. For then the optionee will find it unprofitable to exercise his rights.

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[3] The put and call market is highly specialized; as of 1959, there were less than 15 active broker-dealer firms and under 600 writers. See SEC, Report on Put and Call Options ("Report") 54, 63 (1961).

[4] For further details of the put and call market, see generally Report.

[5] *I.e.*, apart from taking some additional position in the stock on which the option is written.

From March 29, 1956, to August 7, 1958, Reinach wrote 412 option contracts. In the case of options which were exercised, his behavior is significant: In every case of an exercised put, Reinach disposed of the put stock immediately; he never held onto a stock put to him in order to speculate on a subsequent price rise. In the case of calls, in not one instance did he own (or was he "long") the shares involved in these options when he wrote them.[6] In operation, the optionee would present the call to Ira Haupt & Company ("Haupt"), the endorser,[7] which then notified Reinach that Haupt had contracted on his account to deliver shares to the optionee. At the same time, Haupt would collect the option price for the stock from the optionee, and credit it to Reinach. On 96 of the 122 occasions when calls were exericsed, Reinach ordered Haupt, as his broker, to purchase immediately shares in the market to cover those Haupt had bound itself as endorser to deliver to the optionee. But on 26 occasions, Reinach departed from his usual course of not taking a position in the stock involved in an option and he "went short" the stock called. In other words, he entered a short sale arrangement with his broker Haupt whereby Haupt agred that Reinach did not have to replace immediately the stock it had delivered to the optionee. Eventually, Reinach purchased equivalent stock in the market to "cover" the short sale, *i.e.*, repay Haupt for the loan of stock. Seven of such short sale transactions culminated on December 28, 1959;

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[6] It is of incidental interest that in this respect, Reinach differed from most writers, 80% of whom were long on calls they wrote. Report 57 (1959 figure); Record, pp. 32-33.

[7] Reinach had been an employee and then partner at Haupt in the period 1946-1956. He maintained regular trading accounts with the firm in addition to using it as his regular option endorser.

although one brought Reinach a profit, the eventual purchase price Reinach paid [8] on the other six was in excess of the original premium and striking price Reinach had received from the call optionee. It is Reinach's contention that for tax purposes this difference is his net loss and that his total net losses on the transactions of over $59,000 are ordinary losses. What is actually involved can be illustrated better by an example, one of the seven transactions in this appeal.

On December 20, 1957, taxpayer wrote a six month and ten day [9] call on 100 shares of Polaroid. He received a $650 premium. On May 26, 1958, the call was exercised. Haupt delivered the stock to the optionee, leaving Reinach at that point short 100 shares to Haupt; Reinach received the net option or striking price of $4,627.65. In other words, the net striking price was about $46.28 per share.[10] We can infer from the exercise of the option that the stock was selling at more than the striking price on May 26, 1958. If it was selling for less than $52.77, Reinach would have made a profit had he immediately purchased stock to repay Haupt, since he had received a total consideration of $5,277.65 (premium of $650 for writing the option plus striking price of $4,627.65), approximately $52.77 per share.

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[8] Plus dividends which had been earned on the stock in the short sale period; Reinach also owed Haupt these dividends declared while the shares were "loaned" to him.

[9] The 10 days beyond 6 months are designed to enable the optionee to establish a long-term capital gain, as taxpayer himself has pointed out. A. Reinach, An Introduction to the Option (Put and Call) Business 7 (1959); Report 26.

[10] The actual striking price was $46.75/share, but for purposes of this example all figures are net of dividends, commissions, etc., as they appear in the Tax Court chart in its findings of fact.

However, the record does not disclose what the market price of Polaroid was on that date, so we cannot tell how taxpayer then stood. As he explained, Reinach considered that the price of Polaroid would soon decline and therefore decided not to close out the call transaction by buying stock to repay Haupt; instead he extended it by remaining short. In brief, taxpayer was taking a new speculative position in his stock, one which was to extend far beyond that involved in the option he had written. Finally, one year and seven months later on December 28, 1959, taxpayer bought stock to cover this short sale.[11] But by then the cost of shares equivalent to the 100 he had borrowed had risen to $18,432.38, or $184.32 per share. In addition, he owed Haupt $239.75 for dividends earned during the short sale period, another $2.40 per share. For tax purposes, Reinach considered that the event requiring recognition of loss was the purchase of stock to cover the short sale. In computing the loss, he added the premium and striking price he had received in 1958 ($5,277.65) and subtracted his cost items, the cover price in 1959 and dividend expense ($18,432.38 + $239.75 = $18,672.13). He thus reported a loss of $13,394.48. Reinach handled the other five loss transactions in a similar manner.

The Commissioner has no objection to the items in taxpayer's computations; he agrees that it was proper to consider an option and short sale a single transaction remaining open until the cover stock was acquired. Where the Commissioner and taxpayer differ is in their characterization of the transactions and the losses as capital or ordinary. Both taxpayer and the Commissioner rely on section

[11] The stock was not delivered until January 4, 1960, forming the basis of the second issue on appeal—in which year the loss was incurred.

1221(1) of the Int. Rev. Code of 1954,[12] which defines a capital asset as follows:

> For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—
>
> (1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; . . . .

Section 1233 (a) of the Code deals specifically with short sales and provides:

> (a) Capital assets.—For purposes of this subtitle, gain or loss from the short sale of property, other than a hedging transaction in commodity futures, shall be considered as gain or loss from the sale or exchange of a capital asset to the extent that the property, including a commodity future, used to close the short sale constitutes a capital asset in the hands of the taxpayer.

It is thus apparent that the definition of capital asset in section 1221 controls the tax effect of a short sale under section 1233. Taxpayer claims that the way he conducted his occupation of writing puts and calls constituted a trade or business and that he had customers, the persons for whom he performed the service of writing options and meeting his obligations on them, brokers in the former and the public in the latter. Taxpayer goes on to argue

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[12] Hereinafter referred to by section only.

that he purchased stock for only one reason—for sale to customers in the ordinary course of his business. Section 1221(1). Thus, he claims that since he only held stock for sale to customers, the stock involved in covering each short sale was not a capital asset, and he is entitled to ordinary loss treatment. Section 1233(a).

Alternatively, taxpayer relies on *Corn Products Ref. Co.* v. *Commissioner,* 350 U. S. 46 (1955). There the Court affirmed a judgment for the Commissioner, holding under a previous statute that dealings in grain futures by a grain products manufacturer not for speculation, but as "an integral part of its business designed to protect its manufacturing operations against a price increase in its principal raw material and to assure a ready supply for future manufacturing requirements," were not capital transactions, being so intimately related to the company's normal business. *Id.* at 50. Thus, taxpayer contends that his acquisitions of stock were infrequent but integral to his true business of writing options. Taxpayer and the Commissioner agree that when an option is not exercised, a writer must declare the premium as ordinary income. In taxpayer's case, less than thirty per cent of the options he wrote were exericsed, making the bulk of his gains taxable as ordinary income. Yet, when an option is exercised, the Commissioner insists that gain or loss must be treated as capital because the purchase or sale of stock is involved. Thus, all the losses taxpayer incurs in writing options must be capital ones. Taxpayer argues that the *Corn Products* doctrine ought to save him from this fractionalization of his business.

There is surface appeal to taxpayer's argument that he ought not be required to pay tax on ordinary income for gains yet incur capital losses for two aspects of essentially the same business, the occasions for loss—exercise of op-

tions—occurring only because his market prognosis was less accurate.[13] But that is not the case before us. We have seven instances where Reinach honored a call option by borrowing from Haupt the stock to be delivered to the optionee. Then after periods ranging from a minimum of one year seven months to three and one-half years later, Reinach covered the loans with stock purchases leading in six instances to losses. Whatever we might think about stock bought to honor a call or disposed of following a put within a few days after their exercise, we do not consider stock borrowed for one and one-half to three and one-half years thereafter to have been "held by the taxpayer *primarily* for sale to customers. . . ." Section 1221(a). (Emphasis added.) See *Malat* v. *Riddell*, 383 U. S. 569, 572 (1966) (*per curiam*). Reinach argues on appeal that the object of his business of writing stock options was to earn a fee and that he "did not intend to either buy or sell stock except as required to fulfill options which he wrote." But it is apparent that Reinach sold the stock short not "primarily" to pay off the call optionee—he could easily have done that, as he usually did, by immediately covering the loan of stock to him from Haupt. Reinach went short for a purpose entirely divorced from his put and call writing. He did it for the same reason an ordinary trader might have—because he anticipated a decline in the stock's price.

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[13] Of course, there are other countervailing considerations taxpayer has largely ignored. A writer, though he does not own the stock, may profit even when a call option is exercised; *e.g.*, if he received a $200 premium for a call on 100 shares at a striking price of $800 ($8/share), if the stock is selling at $9/share the option will be exercised, but the writer will profit $100, assuming he buys the shares in the open market for $900. Here, he will get capital gain treatment on his profit. Rev. Rul. 58-234, 1958-1 Cum. Bull. 279. Moreover, if Reinach's short sales involved in this case had been profitable, he would have received capital gain treatment—as indeed he did on the one transaction that showed a profit.

Traders in securities receive capital gain and loss treatment. E.g., *Commissioner* v. *Burnett,* 118 F. 2d 659 (5th Cir. 1941); see 3B Mertens, Federal Income Taxation §22.153 (rev. ed. 1966). When Reinach persisted in his decision to go short for such lengthy periods of time rather than covering immediately, it could no longer be said [14] that the stock he sold short was held primarily for sale to any alleged customer. Reinach made his choice to keep the transaction open; that implied a parallel choice to transform this transaction from the ordinary exercise of an option into a short sale extending over a period of many months or even years. Indeed, he had much to gain thereby. He could have controlled the year in which gain or loss was recognized and might have been able to cut his losses if the market had declined for a particular stock. If one or more of the transactions thus eventually turned out to be profitable, he would have been entitled to consistent capital treatment so that capital losses could have offset the gain.

It needs little further elaboration to show that *Corn Products* is similarly no comfort to taxpayer. It suffices to say that *Corn Products* does not protect transactions essentially not related to the taxpayer's principal business, upon which he is taxed at ordinary rates.

The second question raised on appeal—when Reinach's losses occurred—is only significant in relation to the amount of loss taxpayer could claim as an ordinary loss carryback to 1956. See section 172. Since we have held that Reinach's losses were capital, like the Tax Court, we need not reach this issue.

Affirmed.

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[14] Assuming *arguendo* that at one point it could.

APPENDIX "B"

Statutes Involved

INTERNAL REVENUE CODE OF 1954

[Sec. 165]

SEC. 165. LOSSES.

[Sec. 165(a)]

(a) General Rule—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

[Sec. 165(b)]

(b) Amount of Deduction—For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

[Sec. 165(c)]

(c) Limitation on Losses of Individuals.—In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) losses incurred in a trade or business;

(2) losses incured in any transaction entered into for profit, though not connected with a trade or business; and

(3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. A loss

described in this paragraph shall be allowed only to the extent that the amount of loss to such individual arising from each casualty, or from each theft, exceeds $100. For purposes of the $100 limitation of the preceding sentence, a husband and wife making a joint return under section 6013 for the taxable year in which the loss is allowed as a deduction shall be treated as one individual. No loss described in this paragraph shall be allowed if, at the time of filing the return, such loss has been claimed for estate tax purposes in the estate tax return.

[Sec. 212]

SEC. 212. EXPENSES FOR PRODUCTION OF INCOME.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax.

[Sec. 1221]

SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in

the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, or similar property, held by—

(A) a taxpayer whose personal efforts created such property, or

(B) a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property;

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1); or

(5) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

[Sec. 1233]

SEC. 1233. GAINS AND LOSSES FROM SHORT SALES.

[Sec. 1233(a)]

(a) Capital Assets.—For purposes of this subtitle, gain or loss from the short sale of property shall be considered as gain or loss from the sale or exchange of a capital asset to the extent that the property, including a commodity future, used to close the short sale constitutes a capital asset in the hands of the taxpayer.

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 292

ANTHONY M. REINACH, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

This case presents the question whether a writer of "put" and "call" stock options who, in response to the exercise of some of the call options, made "short sales" of the stock called, rather than cover his position by immediate purchase in the market of the stock called, is entitled to deduct the resulting losses as ordinary rather than capital losses, and thus take advantage of the carryback allowed such ordinary losses.[1]

[1] Taxpayer's alternative contention (Pet. 10) that he should be allowed to deduct amounts paid to the broker-lender of the stock sold short, attributable to dividends declared on such stock, was not presented to the Tax Court or on the appeal from that court's decision. It was first raised in his petition for

The court below, affirming the Tax Court, held that the losses were deductible only as capital losses under Sections 1221(1) and 1233(a) of the Internal Revenue Code of 1954. Its decision is correct and there is no conflict or other occasion for further review by this Court.

1. Between March 1956 and August 1957, the taxpayer wrote 412 "put" and "call" stock options, of which 122 call options were exercised.[2] With respect to 96 of the exercised call options, taxpayer immediately purchased in the market the shares delivered to the optionee. As to the remaining 26, however, he went "short", borrowing from his broker the stock delivered to the optionee and then waiting for periods ranging from one year seven months to three and one-half years before purchasing stock on the exchange to cover his short position. Six of the 26 short sale transactions resulted in the losses here in issue. (Pet. A 3–5.)

Section 1221(1) of the 1954 Code excludes from the category of capital assets property held by the taxpayer "primarily for sale *to customers* in the ordinary course of his trade or business". (Emphasis added.) Section 1233(a) provides that "gain or loss from the

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rehearing in the Court of Appeals, which was denied. (R. Vol. II, pp. 22–23). Moreover, the record does not reveal the amounts paid during the taxable years; it does appear that taxpayer has been allowed a deduction of $1,694.25 for such amounts in computing the deficiencies in issue. Notice of Deficiency, p. 3, par. (e), Ex. A to Petition in Tax Court.

[2] The nature of "put" and "call" stock options, and the manner they are written by the optionor and exercised by the optionee, are described in the opinion below (Pet. A 1–2).

short sale of property shall be considered as gain or loss from the sale or exchange of a capital asset to the extent that the property * * * used to close the short sale constitutes a capital asset in the hands of the taxpayer".

As the court below pointed out (Pet. A 8-9), the taxpayer's short sales were "entirely divorced from his put and call writing". His short positions were not part of his business of writing call options. They rather represented separate transactions that were not required by the exercise of the calls, as his behavior on 96 of the 122 calls demonstrates. Thus such transactions did not involve goods "held primarily for sale to customers in the ordinary course of his trade or business" of writing options. The taxpayer was a trader, not a dealer, in the securities sold short, and therefore was not entitled to deduct the short sales losses as ordinary losses. See *Mirro-Dynamics Corp.* v. *United States,* 374 F. 2d 14 (C.A. 9), 1967, petition for writ of certiorari filed July 13, 1967, No. 357, this Term; *Commissioner* v. *Burnett,* 118 F. 2d 659 (C.A. 5); *Faroll* v. *Jarecki,* 231 F. 2d 281 (C.A. 7), certiorari denied, 352 U.S. 830; 3B Mertens, *Law of Federal Income Taxation* (Rev.) Section 22:153, p. 937; H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 22. Accordingly, the securities sold short were capital assets as defined in 1954 Code Section 1221(1), and the losses resulting from the short sales were capital losses under Section 1233(a).

2. There is no conflict with any decision of this Court or of any court of appeals. Indeed, this is the first case to present the issue here involved, and it

turns on its own facts. *Williamson* v. *Commissioner*, 201 F. 2d 564 (C.A. 4), certiorari denied, 345 U.S. 970, the lone appellate court case upon which the taxpayer relies for conflict, dealt with different facts and a different issue. It did not involve options to buy or sell, nor short sales by an optionor, as does this case. There, immediate sales and deliveries of cotton were made, the price to remain open for an agreed period during which the seller might "call" the price at the market price on any day. The word "call" in *Williamson* referred only to the determination of the price to be paid for the cotton, and not to any option.

3. This case lacks sufficient importance to warrant further review. Sales pursuant to the exercise of call options represent an insignificant portion of the total transactions in securities. See SEC Report on Put and Call Options 54, 63 (1961). Furthermore, the practice of the taxpayer in writing options without owning the stocks, and consequently selling short, deviated from the general practice of option writers. *Id.* at 5, 6, 56–57.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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AUGUST 1967.

U.S. GOVERNMENT PRINTING OFFICE: 1967